



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Uniform Issue List 402.08-00
415.01-00
415.02-00

200719014

FEB 12 2007

T:EP:RA:TB

LEGEND:

City A:

Plan X:

Dear

This letter is in response to a request for a ruling letter submitted on your behalf by your authorized representative on September 15, 2003, as supplemented by letters dated March 23, 2006, and August 31, 2006, concerning the federal income tax consequences of certain transfers involving a defined benefit pension plan and an eligible deferred compensation plan under section 457 of the Internal Revenue Code ("Code"). The following facts and representations have been submitted in support of the requested rulings.

City A maintains Plan X for certain employees who have enforcement authority or duties ("police employees"). Plan X is a governmental plan within the meaning of Code section 414(d) and a defined benefit plan. Plan X is intended to satisfy the requirements of Code section 401(a) which are applicable to governmental plans. City A also maintains an eligible deferred compensation plan under Code section 457 ("457 Plan"). Police employees, as well as certain other employees of City A, are eligible to participate in the 457 Plan. However, the police employees involved in this ruling request are no longer allowed to receive future contributions (employee deferrals or City A matching contributions) to the 457 Plan. Such police employees have "frozen accounts" in the 457 Plan.

Plan X provides for mandatory employee contributions. City A also makes employer contributions to Plan X as actuarially determined to be necessary to fund the pension benefits under Plan X. Plan X was amended on _____, to provide for an increase in the

normal monthly retirement benefit accruing for each year of service after October 1, 1997. This amendment increased the benefit that will accrue for each year of service after October 1, 1997, from _____ of average final monthly compensation (as defined in Plan X). Such increased pension is provided only for police employees who are not actively participating in the 457 Plan. Police employees who previously participated in the 457 Plan but who recently made an irrevocable election to cease future participation in the 457 Plan are entitled to a normal monthly retirement benefit under Plan X equal to _____ of average final monthly compensation multiplied by their years of credited service after October 1, 1997. These employees are also entitled, under Plan X, to normal monthly retirement benefits equal to _____ of their average final monthly compensation multiplied by their years of credited service prior to October 1, 1997.

Plan X provides that a police employee who is entitled to a monthly pension equal to _____ of his average final monthly compensation for years of credited service after October 1, 1997, may purchase an additional benefit ("Additional Benefit") equal to _____ of his average final monthly compensation multiplied by the number of his years of credited service prior to October 1, 1997, so that such additional benefit, if purchased, would increase his total pension benefit for pre-October 1, 1997, years from _____ to _____. Police employees who purchase the additional benefit as described in the preceding sentence have already accrued in Plan X the _____ pension for years of service prior to October 1, 1997.

Plan X provides that a police employee may purchase the Additional Benefit by making a cash payment of funds not related to any retirement plan (after-tax funds) or by transferring or rolling over to Plan X funds from another retirement plan, including the 457 Plan. Your authorized representative has represented that the rollover contributions are rollover contributions as defined in section 402(c)(1) of the Code. The amount of the payment for the Additional Benefit is an amount which the Plan X administrator determines (calculated on a consistent basis for all electing police employees) is necessary to cover the employee contribution portion of the cost for the additional _____ benefit attributable to the purchased Additional Benefit. Your authorized representative has represented that the method to determine the benefit attributable to rollover contributions for purposes of section 415 is based on reasonable actuarial assumptions that are not more favorable than those specified in section 411(c) of the Code. Plan X specifically limits transfers or rollovers of funds from the 457 Plan (to purchase the additional benefit) to transfers or rollovers that will not cause Plan X to lose its status as a retirement plan qualified under section 401(a) of the Code. The 457 Plan provides for direct trustee-to-trustee transfers under section 401(a)(31) of the Code.

Your authorized representative has requested the following rulings on your behalf:

4. A direct trustee-to-trustee transfer at the request of the police employee/participant pursuant to Code section 401(a)(31) (after the police employee/participant has severed employment with City A) of an eligible rollover distribution from the 457 Plan to Plan X to purchase the additional benefit under Plan X is a permissible trustee-to-trustee transfer under Code section 457(e)(16) and will not result in ordinary income to the police employee under sections 457(a), 402(a), or 72 of the Code.

5. A rollover (within 60 days after receiving the distribution) of all or part of an eligible rollover distribution from the 457 Plan (received by a police employee after severance from employment with City A) to Plan X to purchase the additional benefit is a permissible rollover to Plan X under Code section 457(e)(16) and will not result in ordinary income to the police employee/distribute under sections 457(a), 402(a) or 72 of the Code.

6. The amounts transferred to Plan X as a rollover from the 457 Plan pursuant to section 457(e)(16) or as a direct trustee-to-trustee transfer pursuant to sections 457(e)(16) and 401(a)(31) to purchase the additional benefit under Plan X will not be treated, in Plan X, as either (i) the "annual benefit" within the meaning of Code section 415(b)(2)(A) for purposes of determining limitations for defined benefit plans, or (ii) an "annual addition" within the meaning of Code section 415(c)(2) for purposes of determining the limitations for defined contribution plans.

Requested rulings 1, 2 and 3 were withdrawn in a letter dated March 23, 2006, from your authorized representative.

With respect to your fourth and fifth requested rulings, Code section 72(a) provides in general that gross income includes any amount received as an annuity under an annuity, endowment, or life insurance contract.

Code section 401(a)(31)(A) provides in general that a trust shall not constitute a qualified trust under section 401(a) unless the plan of which such trust is a part provides that if the distributee of any eligible rollover distribution elects to have such distribution paid directly to an eligible retirement plan, and specifies the eligible retirement plan to which such distribution is to be paid (in such form and at such time as the plan administrator may prescribe), such distribution shall be made in the form of a direct trustee-to-trustee transfer to the eligible retirement plan so specified.

Code section 401(a)(31)(D) states that, for purposes of this paragraph, the term "eligible retirement plan" has the meaning given such term by section 402(c)(8)(B), except that a qualified trust shall be considered an eligible retirement plan only if it is a defined contribution plan, the terms of which permit the acceptance of rollover distributions. However, section 1.401(a)(31)-1, Q & A-2, of the regulations states in pertinent part that a plan is permitted, at a participant's election, to make a direct rollover to any type of retirement plan, as defined in section 402(c)(8)(B) (including a defined benefit plan).

Code section 402(a) provides in general that any amount actually distributed to any distributee by any employees' trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to the distributee, in the taxable year of the distributee in which distributed, under section 72 (relating to annuities).

Code section 402(c)(1) states that if any portion of the balance to the credit of an employee in a qualified trust is paid to the employee in an eligible rollover distribution, the distribute transfers any portion of the property received in such distribution to an eligible retirement plan, and in the case of a distribution of property other than money, the amount so transferred consists of the

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property distributed, then such distribution (to the extent so transferred) shall not be includible in gross income for the taxable year in which paid.

Code section 402(c)(4) provides that, for purposes of this subsection, the term "eligible rollover distribution" means any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified trust, with certain exceptions for substantially equal periodic payments, required minimum distributions, and hardship distributions.

Code section 402(c)(3)(A) generally provides that the transfer described in section 402(c)(1) must be made within 60 days of receipt, subject to the hardship exception described in subparagraph (B).

Code section 402(c)(8)(B) states in pertinent part that the term "eligible retirement plan" means a qualified trust.

Code section 457(a) provides generally that any amount of compensation deferred (and income attributable to amounts so deferred) under an eligible deferred compensation plan of a governmental entity shall be includible in gross income only for the taxable year in which such compensation or other income is paid to the participant or other beneficiary.

Code section 457(e)(16)(A) provides generally that amounts paid to an employee in an eligible rollover distribution from an eligible deferred compensation plan can be rolled over to an eligible retirement plan, described in Code section 402(c)(8)(B) in accordance with the rules of Code section 402(c).

Code section 457(e)(16)(B) states that, for purposes of subparagraph (A), the rules of Code section 402(c)(2) through (7) and (9) and section 402(f) apply.

Section 1.457-7(b)(2) of the Income Tax Regulations ("regulations") provides in general that a trustee-to-trustee transfer in accordance with Code section 401(a)(31) from a section 457 plan is not includible in gross income of a participant or beneficiary in the year transferred. Section 1.457-7(b)(2) of the Proposed Regulations also provides that any payment from a section 457 plan made in the form of an eligible rollover distribution (as defined in Code section 402(c)(4)) is not includible in gross income in the year paid to the extent the payment is transferred to an eligible retirement (as defined in Code section 402(c)(8)(B)) within 60 days.

With respect to your fourth and fifth requested rulings, the 457 Plan provides that participants can request a rollover in the form of a direct trustee-to-trustee transfer to an eligible retirement plan. Plan X is an eligible retirement plan within the meaning of Code section 402(c)(8)(B), and it accepts eligible rollover distributions from either the trustee of the distributing plan or the participant.

Accordingly, with respect to your fourth requested ruling, we conclude that a direct trustee-to-trustee transfer at the request of the police employee/participant pursuant to Code section 401(a)(31) (after the police employee/participant has severed employment with City A) of an

eligible rollover distribution from the 457 Plan to the Plan X to purchase the additional benefit under Plan X is a permissible trustee-to-trustee transfer under Code section 457(e)(16) and will not result in ordinary income to the police employee under sections 457(a), 402(a), or 72 of the Code, to the extent that it is otherwise an eligible rollover distribution and the requirements of Code section 402(c) are met.

With respect to your fifth requested ruling, we further conclude that a rollover (within 60 days after receiving the distribution) of all or part of an eligible rollover distribution from the 457 Plan (received by a police employee after severance from employment with City A) to Plan X to purchase the annual benefit is a permissible rollover to Plan X under Code section 457(e)(16) and will not result in ordinary income to the police employee/distributee under sections 457(a), 402(a) or 72 of the Code, to the extent that it is otherwise an eligible rollover distribution and the requirements of Code section 402(c) are met.

With respect to your sixth requested ruling, Code section 411(c) sets forth rules for allocating accrued benefits between employer and employee contributions.

Code section 415 sets forth limitations on benefits and contributions under qualified plans. With respect to defined benefit plans, Code section 415(b)(1) provides that benefits with respect to a participant exceed the limitation of this subsection, if, when expressed as an annual benefit (within the meaning of paragraph (2)), such annual benefit is greater than the lesser of \$ or of the participant's average compensation for his high 3 years. With respect to defined contribution plans, Code section 415(c)(1) states that contributions and other additions with respect to a participant exceed the limitation of this subsection if, when expressed as an annual addition (within the meaning of paragraph (2)) to the participant's account, such annual addition is greater than the lesser of \$ or percent of the participant's compensation.

Code section 415(b)(2)(A) provides in pertinent part that the term "annual benefit" means a benefit payable annually in the form of a straight life annuity (with no ancillary benefits) under a plan to which employees do not contribute and under which no rollover contributions (as defined in specified Code sections) are made.

Code section 415(b)(2)(B) states in pertinent part that if the employees make rollover contributions (as defined in sections 402(c) and 457(e)(16)), the determinations as to whether the limitation described in paragraph (1) has been satisfied shall be made, in accordance with regulations prescribed by the Secretary, by adjusting such benefit so that it is equivalent to the benefit described in subparagraph (A).

Code section 415(c)(2) states that, for purposes of paragraph (1), the term "annual addition" means the sum for any year of employer contributions, the employee contributions, and forfeitures. Section 415(c)(2) further states in pertinent part that, for the purposes of this paragraph, employee contributions under subparagraph (B) are determined without regard to any rollover contributions (as defined in sections 402(c) and 457(e)(16)).

Section 1.415-3(b)(1)(i) of the regulations states in pertinent part that the term "annual benefit" does not include any benefits attributable to rollover contributions (as described in section 402(a)(5), which is currently section 402(c)(1)).

Under section 1.415-3(b)(1)(iii) of the regulations, if rollover contributions are made to the plan, the annual benefit attributable to these contributions is determined on the basis of reasonable actuarial assumptions.

Section 1.415-3(d)(2) of the regulations states in pertinent part that where a defined benefit plan provides for voluntary employee contributions, these contributions are considered a separate defined contribution plan maintained by the employer which is subject to the limitations on contributions and other additions described in section 1.415-6.

Section 1.415-6(b)(3)(i) of the regulations states in pertinent part that the term "annual addition" does not include rollover contributions as defined in section 402(a)(5) (which is currently section 402(c)(1)).

With respect to your sixth requested ruling, section 1.415-3(b)(1)(i) of the regulations provides that benefits attributable to rollover contributions are not included in the annual benefit, while section 1.415-3(b)(1)(iii) provides that such benefits are determined on the basis of reasonable actuarial assumptions. Accordingly, benefits attributable to rollover contributions which are determined on the basis of reasonable actuarial assumptions are not included in the annual benefit. In the present case, your authorized representative has represented that the method to determine the benefit attributable to rollover contributions for purposes of section 415 is based on reasonable actuarial assumptions that are not more favorable than those specified in section 411(c) of the Code. Therefore, the benefits attributable to the rollover contributions in the present case are not annual benefits within the meaning of section 1.415-3(b)(1) of the regulations. Your authorized representative has also represented that the rollover contributions are rollover contributions as defined in section 402(c)(1) of the Code. Accordingly, these rollover contributions are not annual additions within the meaning of section 1.415-6(b)(3) of the regulations.

Therefore, with respect to your sixth requested ruling, we conclude that the amounts transferred to Plan X as a rollover from the 457 Plan pursuant to section 457(e)(16) or as a direct trustee-to-trustee transfer pursuant to sections 457(e)(16) and 401(a)(31) to purchase the additional benefit under Plan X will not be treated, in Plan X, as either (i) an "annual benefit" within the meaning of Code section 415(b)(2)(A) for purposes of determining limitations for defined benefit plans, or (ii) an "annual addition" within the meaning of Code section 415(c)(2) for purposes of determining the limitations for defined contribution plans.

This ruling letter is based on the assumption that Plan X is qualified under Code section 401(a) at all times relevant to the transaction described herein.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

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A copy of this ruling letter has been sent to your authorized representative in accordance with a power of attorney on file with this office.

If you have any questions, please contact
Please refer to SE:T:EP:RA:T3.

at

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Frances V. Sloan".

Frances V. Sloan, Manager
Employee Plans Technical Group 3

Enclosures
Notice 437
Deleted copy of ruling letter